



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

JAN 23 2007

THE ASSISTANT SECRETARY

FP-07-01

Subject: FFELP Loans Eligible for 9.5 Percent Minimum Special Allowance Rate

Summary: This letter restates the applicable requirements of the HEA and regulations that control whether FFELP loans acquired with funds derived from tax-exempt financing sources acquire eligibility for special allowance payments at the 9.5 percent minimum return rate

Dear Colleague:

Recent examination of activities involving tax-exempt financing of Federal Family Education Loan Program (FFELP) loans indicates that it is appropriate to restate the requirements of the Higher Education Act of 1965, as amended (HEA) and the Department's regulations that control whether FFELP loans made or acquired with funds derived from tax-exempt financing sources acquired eligibility for SAP at the 9.5 percent minimum return rate.

The HEA identifies the specific sources of funds derived from a tax-exempt obligation that can be used to acquire loans that qualify for SAP at the 9.5 percent minimum return rate. 20 U.S.C. § 1087-1(b)(2)(B)(i)(2006). These sources are: (1) funds obtained from the issuance of a tax-exempt obligation originally issued prior to October 1, 1993 or from investment earnings on the proceeds of such an obligation; and (2) funds obtained as collections on, interest benefits or special allowance payments on, or income on, loans made or purchased from the proceeds of that tax-exempt obligation. *Id.* The regulations describe these sources of funds in precise terms, as follows:

(c)(3)(i) . . . the special allowance rate is one-half of the rate calculated under paragraph (c)(1)(iii)(F) of this section for a loan made or guaranteed on or after October 1, 1980 that was made or purchased with funds obtained by the holder from--

(A) The proceeds of tax-exempt obligations originally issued prior to October 1, 1993;

(B) Collections or payments by a guarantor on a loan . . . purchased with funds obtained . . . from obligations described in paragraph (c)(3)(i)(A) of this section;

(C) Interest benefits or special allowance payments on a loan . . . purchased with funds obtained . . . from obligations described in paragraph (c)(3)(i)(A) of this section;

(D) The sale of a loan . . . purchased with funds obtained . . . from obligations described in paragraph (c)(3)(i)(A) of this section;¹ or

¹ The term "sale" as used in paragraph (c)(3)(i)(D) includes both a sale to a third party and an intra-portfolio transfer of loans.

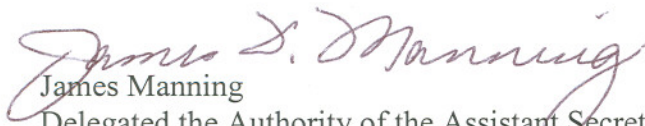
(E) The investment of the proceeds of obligations described in paragraph (c)(3)(i)(A) of this section.

34 C.F.R. § 682.302(c)(3)(i) (2006). These requirements have been in effect since 1993. Only the loans described in these statutory and regulatory provisions are eligible for SAP at the 9.5 percent minimum return rate. Each of the five categories (paragraphs (c)(3)(i)(A) through (c)(3)(i)(E)) includes funds separate and distinct from the funds in any other category. Each category of funds includes only those funds obtained directly from the specific source named in that paragraph.

Loans acquired from these five sources can be divided into two categories. The first category is “first-generation loans” – and includes only those loans acquired using proceeds of the tax-exempt obligation (*i.e.*, funds obtained directly from the issuance of the tax-exempt obligation). *See* 34 C.F.R. § 682.302(c)(3)(i)(A) (2006). The second category is “second-generation loans” – and includes only those loans acquired using funds obtained directly from first-generation loans.² *See* 34 C.F.R. § 682.302(c)(3)(i)(B)-(D) (2006). Funds obtained as collections on second-generation loans, interest and special allowance payments on second-generation loans, or sales of second-generation loans, or those same kinds of funds obtained from later generation loans, are not eligible sources of funds under the statute or regulation. Therefore, loans acquired with funds from second-generation loans or later generations of loans are not eligible for SAP at the 9.5 percent minimum return rate.

Further, the Department pays SAP if it receives an accurate and complete request for payment from a lender. 20 U.S.C. § 1087-1(b)(3) (2006). A request for payment is accurate and complete if it contains all the information required by the Department, and does not include any loans that the Department has directed the lender to exclude from its request. 34 C.F.R. § 682.305(b)(5) (2006).

Finally, for your information, I have attached a more detailed letter that was sent to all lenders currently claiming SAP at the 9.5 percent minimum return rate.


James Manning
Delegated the Authority of the Assistant Secretary
Office of Postsecondary Education

² Loans from investments of proceeds, described in paragraph (c)(3)(i)(E), are like second-generation loans – the loans themselves qualify for the minimum rate, but loans acquired with funds obtained as collections, interest and SAP, or the sale of those loans described in paragraph (c)(3)(i)(E) do not. To ensure clarity regarding the eligibility of loans made from various funding sources, therefore, any references here to second-generation loans are to be understood to include loans made from investment earnings.

January 24, 2007

Dear _____:

Our records show that you recently submitted a request for special allowance payments (SAP) on Federal Family Education Loan Program (FFELP) loans. Your request included a claim(s) for SAP at the 9.5 percent minimum return rate under 20 U.S.C. §1087-1(b)(2)(B)(i)(2006). The purpose of this letter is to provide guidance to you on the requirements applicable to claims for SAP at the 9.5 percent minimum return rate.

Recent examination of activities involving tax-exempt financing of FFELP loans indicates that it is appropriate to restate the requirements of the Higher Education Act of 1965 as amended (HEA) and the Department's regulations that control whether FFELP loans made or acquired with funds derived from tax-exempt financing sources acquire eligibility for SAP at the 9.5 percent minimum return rate.

The HEA identifies the specific sources of funds derived from a tax-exempt obligation that can be used to acquire loans that qualify for the 9.5 percent minimum SAP rate. 20 U.S.C. § 1087-1(b)(2)(B)(i)(2006). These sources are: (1) funds obtained from the issuance of a tax-exempt obligation originally issued prior to October 1, 1993 or from investment earnings on the proceeds of such an obligation; and (2) funds obtained as collections on, interest benefits or special allowance payments on, or income on, loans made or purchased from the proceeds of that tax-exempt obligation. *Id.* The regulations describe these sources of funds in precise terms, as follows:

(c)(3)(i) . . . the special allowance rate is one-half of the rate calculated under paragraph (c)(1)(iii)(F) of this section for a loan made or guaranteed on or after October 1, 1980 that was made or purchased with funds obtained by the holder from--

(A) The proceeds of tax-exempt obligations originally issued prior to October 1, 1993;

(B) Collections or payments by a guarantor on a loan . . . purchased with funds obtained . . . from obligations described in paragraph (c)(3)(i)(A) of this section;

(C) Interest benefits or special allowance payments on a loan . . . purchased with funds obtained . . . from obligations described in paragraph (c)(3)(i)(A) of this section;

(D) The sale of a loan . . . purchased with funds obtained . . . from obligations described in paragraph (c)(3)(i)(A) of this section;¹ or

(E) The investment of the proceeds of obligations described in paragraph (c)(3)(i)(A) of this section.

34 C.F.R. § 682.302(c)(3)(i) (2006). These requirements have been in effect since 1993. Only the loans described in these statutory and regulatory provisions are eligible for SAP at the 9.5 percent minimum return rate. Each of the five categories (paragraphs (c)(3)(i)(A) through (c)(3)(i)(E)) includes funds separate and distinct from the funds in any other category. Each category of funds includes only those funds obtained directly from the specific source named in that paragraph.

Loans acquired from these five sources can be divided into two categories. The first category is “first-generation loans” – and includes only those loans acquired using proceeds of the tax-exempt obligation (*i.e.*, funds obtained directly from the issuance of the tax-exempt obligation). *See* 34 C.F.R. § 682.302(c)(3)(i)(A) (2006). The second category is “second-generation loans” – and includes only those loans acquired using funds obtained directly from first-generation loans.² *See* 34 C.F.R. § 682.302(c)(3)(i)(B)-(D) (2006). Funds obtained as collections on second-generation loans, interest and special allowance payments on second-generation loans, or sales of second-generation loans, or those same kinds of funds obtained from later generation loans, are not eligible sources of funds under the statute or regulation. Therefore, loans acquired with funds from second or later generation loans are not eligible for SAP at the 9.5 percent minimum return rate.

The Department pays SAP if it receives an accurate and complete request for payment from a lender. 20 U.S.C. § 1087-1(b)(3) (2006). A request for payment is accurate and complete if it contains all the information required by the Department, and does not include any loans that the Department has directed the lender to exclude from its request. 34 C.F.R. § 682.305(b)(5) (2006).

Finally, a claim for SAP at the 9.5 percent minimum return rate may be made only for first-generation and second-generation loans, as described above. On the “request for payment” form (Form LaRS 799) that you and other lenders submit to the Department, the certifying official represents that the data on the form conforms to the laws, regulations, and policies applicable to the Federal Family Education Loan Program. By so certifying, the lender represents to the Department that no claim is made on that

¹ The term “sale” as used in paragraph (c)(3)(i)(D) includes both a sale to a third party and an intra-portfolio transfer of loans.

² Loans from investments of proceeds, described in paragraph (c)(3)(i)(E), are like second-generation loans – the loans themselves qualify for the minimum rate, but loans acquired with funds obtained as collections, interest and SAP, or the sale of those loans described in paragraph (c)(3)(i)(E) do not. To ensure clarity regarding the eligibility of loans made from various funding sources, therefore, any references here to second-generation loans are to be understood to include loans made from investment earnings.

request for payment of 9.5 percent SAP on any loans that are not first-generation or second-generation loans.

Although the limitations on eligibility for SAP at the 9.5 percent minimum return rate restated in this letter and in DCL FP-07-01 dated January 23, 2007, have long been reflected in the HEA and the regulations, the Department has reason to believe that some lenders may be claiming 9.5 percent SAP on loans which are neither first-generation nor second-generation loans. Therefore, to ensure proper distribution of payments and to assess the incidence of such claims, the Department will take two steps before we pay any further claims for SAP at the 9.5 percent minimum return rate.

First, we will arrange for an audit or review of the loans on which you are currently claiming SAP at the 9.5 percent rate in order to determine which loans are first-generation and second-generation loans. The audit or review will be conducted by an independent accounting firm. As an alternative, you may arrange for the conduct of an audit or review by an independent accounting firm of your choosing, under a set of requirements to be established by the Department. The Department will pay all claims for SAP at the standard rate until the results of the audit or review have been received, evaluated, and accepted by the Department. We will consider, and rely upon, as appropriate, the results of the audit or review in determining what amount to pay at the 9.5 percent minimum return rate. We will also consider any objections you assert to our determination.

Second, you are to provide--with any request for payment of SAP at the 9.5 percent minimum return rate--a certification, executed by the chief executive officer (CEO) and chief financial officer (CFO) of your organization, that SAP is claimed at the 9.5 percent minimum return rate only for loans which are either first-generation or second-generation loans, and no others. The certification must be in the following form --

We, _____, CEO and _____, CFO of _____ [company name] hereby certify that we have reviewed the billing for special allowance payments under the Federal Family Education Loan Program submitted to the Department of Education by _____ [company name] on _____ [date]. We certify that we have internal controls in place to monitor and ensure the accuracy of the claim presented in this bill, and that as part of our regular annual audit, our independent auditor will attest to the effectiveness of these controls and the accuracy of the billing. Based on our review, we certify that the billing requests special allowance payment at the 9.5 percent minimum return rate only on loans that are first-generation or second-generation loans obtained from an eligible source, as described in the Department's Dear Colleague Letter [FP-07-01] dated January 23, 2007, and no others. We have disclosed to our independent auditors and to the audit committee³ all significant deficiencies in the design and operation of the internal controls that could adversely affect the accuracy

³ If your organization has not established an audit committee, please substitute the director(s), trustee(s) or other authority with responsibility for review of your annual financial statements.

of the information presented herein, as well as any fraud, whether or not material, that involves management or any other employee connected to the information contained in this bill.

Date

Signature

Title

The Department will pay SAP at the standard rate on any request for payment that is not accompanied by this certification.

The Department is committed to resolving without protracted dispute any potential objections both to the meaning and application of the statutory and regulatory requirements as restated in this letter, and to ensuring that SAP is paid at the 9.5 percent minimum return rate only on eligible loans. Therefore, the Department will not seek to recoup SAP already received in excess of that payable at the standard rate for quarters ending on or before September 30, 2006 at the 9.5 percent minimum return rate for loans that were neither first-generation loans nor second-generation loans for those lenders that promptly comply with or accept, as applicable, the following--

1. The statutory and regulatory requirements for eligibility for SAP at the 9.5 percent minimum return rate as restated in this letter;
2. The requirement that a request for payment of SAP at the 9.5 percent rate be supported by the management certification described above; and
3. The Department's payment of all SAP claims at the standard rate, rather than the 9.5 percent minimum return rate, until the Department receives, accepts and evaluates the results of the audit or review described here, and determines, after our consideration of any objection you present, which of the loans on which you currently claim SAP at the 9.5 percent rate are eligible for payment at that rate.

Thank you for your cooperation. Please contact Matteo Fontana, General Manager, Financial Partners Services, at 202-377-3005 if you have any questions regarding the procedures in this letter.

Theresa S. Shaw
Chief Operating Officer
Federal Student Aid